MEMORANDUM

TO: The Rhode Island Public Utilities Commission

FROM: Bruce R. Oliver, Revilo Hill Associates, Inc.

DATE: October 8, 2015

SUBJECT: National Grid Proposed Customer Choice Program Revisions, Docket 4523, Phase II

On August 7, 2015, National Grid (hereinafter "National Grid" or "the Company") submitted testimony proposing changes to its Gas Customer Choice Program and revised tariff pages that would implement the proposed changes. This memorandum provides an assessment of the Company's proposed changes to the Company's Customer Choice Program and the tariff changes that are intended to implement those changes.

EXECUTIVE SUMMARY

National Grid does not presently have the ability to absorb the design day service requirements of all of its current Capacity Exempt customers in Rhode Island, and there is no scenario foreseen at this point under which National Grid would have sufficient capacity at any time in the foreseeable future to serve of the design day requirements of its existing Capacity Exempt customers. National Grid estimates that at present its Capacity Exempt customers represent about 38,000 Dth per day of design day capacity requirements, but the Company indicates that it only has available capacity serve about 2,000 Dth per day (or about 5%) of that load. Thus, the implementation of a program to allow current Capacity Exempt customers to return to capacity assigned service could erode the reliability of service for the Company's existing firm service customers and increase their costs of service without any offsetting benefits. If a program is adopted which provides Capacity Exempt customers the option of returning to capacity assigned service but restricts the amount of load that can be accepted in any year, then the Commission should provide direction regarding the manner in which priorities for the acceptance of transfers to capacity assigned service would be structured.

Furthermore, the Commission must recognize that National Grid's costs for obtaining incremental capacity are substantially above its current average cost of capacity. If capacity charges for customers who elect to return to National Grid for capacity assignments are priced in a manner that reflects the incremental costs of the capacity they require, there would be no need for such customers to be required to take firm gas sales service for a period of time before receiving an assignment of capacity. In addition, appropriate use of incremental pricing can serve to: (1) control the amount of load that requests transfers from Capacity Exempt to Capacity Assigned service; and (2) provide opportunities for marketers to obtain capacity from other sources that they may be able to price at rates competitive with National Grid's offerings.

National Grid should not be required to plan firm design day capacity for customers who do not make a long-term commitment to pay for such capacity. In this context, there is merit to the Company's proposal that the option to return to Capacity Assigned service be offered only as a one-time election, such that once a customer elects to return to Capacity Assigned service, it decision is permanent and the customer must forgo the possibility of returning to Capacity Exempt service at a future point in time.

Finally, the parameters of National Grid's responsibilities with respect to providing service to Capacity Exempt customers who request to be served under the Company's Default Service rates need clarification. National Grid perceives that it has an obligation to serve all Capacity Exempt Default service customers on a firm basis, even under extreme winter weather conditions, despite the fact that it does not plan capacity to serve those customers' requirements. If National Grid's perception is reflective of the Commission's intent, **all Capacity Exempt service should be immediately terminated**, and current Capacity Exempt customers should be required to take and pay for **mandatory assignments** of firm capacity.

RECOMMENDATIONS

1. The Commission should recognize that *National Grid's ability to absorb the capacity requirements of current Capacity Exempt customers in Rhode Island* ***is quite limited.*** Thus, any program modifications that would allow for customer transfers from Capacity Exempt status to Capacity Assigned status must be limited to those that can be accomplished without jeopardizing the reliability of the Company's system in Rhode Island under winter extreme weather conditions.

2. The Commission should agree with the positions of SBE and Direct Energy that National Grid's ***proposal to require Capacity Exempt customers to purchase Firm Gas Sales Service from the Company*** for a period of time to be eligible for Capacity Assigned service ***is unnecessary***. However, given the costs to National Grid of incremental pipeline capacity resources to serve returning Capacity Exempt customers, a Capacity Exempt customer's decision to seek an assignment of capacity (with or without

purchases of firm gas service from the Company), must be subject to incremental pricing for assigned capacity. Moreover, such incremental pricing should reflect the full incremental costs that the customer's return to capacity assigned status can be expected to impose on National Grid's Rhode Island operations over the Company's planning horizon for additional capacity (i.e., at least three years).[1]

3. The Commission should conclude that ***nothing in the Company's proposals requires marketers to "cede" customers*** to the utility, nor do National Grid's proposals place the marketers' relationships with their customers "*at risk*." To the extent that a marketer has attempted to serve Capacity Exempt customers without securing firm capacity commitments, any risk of loss of those customers to the utility is a result of the marketer's own decisions and business strategy.

4. The Commission should ***accept*** National Grid's proposal to provide current Capacity Exempt customers only a ***one-time opportunity to change their capacity assignment status***, and once that election is made it becomes a **permanent commitment**.

5. The Commission should clarify that National Grid's obligation to provide Firm uninterrupted service to Capacity Exempt customers is limited by the amount of its available excess design day capacity.

6. The Commission should anticipate that **marketers will oppose** any effort to incrementally price capacity resources assigned to firm service class to customers who elect to relinquish their Capacity Exempt status in relationship to National Grid's incremental costs of pipeline capacity. Marketers would gain advantage from a policy which enables them to receive capacity assignments for current Capacity Exempt customers at a cost that is below the cost marketers would otherwise have to pay for firm design winter and design day capacity. Given the current market conditions, it appears unlikely that marketers could obtain long-term capacity commitments at prices below the Company's average capacity cost.

[1] To be clear, incremental pricing of capacity assigned to current capacity exempt customers for a period of at least three years is necessary and appropriate regardless of whether a current Capacity Exempt customer takes Firm Gas Sales Service or remains on Firm Transportation Service.

BACKGROUND

The tariff changes National Grid proposes in its August 7, 2015 filing are intended primarily to provide an option for present "Capacity Exempt" customers to elect capacity assignments of capacity from the Company.[2] All current "Capacity Exempt" gas service customers are Large or Extra Large Firm C&I customers who have previously made explicit, non-revocable, decisions to take "Capacity Exempt" service. Each of those customers expressly elected to take service without an allocation of the Company's natural gas pipeline, storage, and peaking resources and associated costs. Rather, they knowingly accepted responsibility to make their own arrangements (through competitive service providers) for any and all capacity resources necessary to ensure their ability to receive uninterrupted natural gas supply service during periods of high gas system demand.

However, few competitive natural gas service providers actually contracted for firm gas supply resources (i.e., firm interstate pipeline capacity and/or local peaking resources to ensure their ability to serve Capacity Exempt customers under extreme weather conditions). The avoidance of commitments to firm natural gas pipeline entitlements and peaking resources, enabled competitive gas service providers to offer natural gas supply service to capacity exempt customers at lower cost than their gas distribution utility since the costs of firm interstate pipeline capacity and local peaking resources represent a significant portion of the utility's costs of providing regulated firm natural gas supply service.

Until recently this strategy for avoiding the on-going costs of annual firm capacity commitments was generally successful. The success of that strategy was the product of two factors. First, utilities such as National Grid and its predecessor organizations in Rhode Island typically maintained substantial excess natural gas supply capacity.[3] Second, National Grid, as well as most other gas distribution utilities in New England, typically maintain portfolios of gas supply capacity resources that were developed over time and comprise substantial capacity at costs below their current costs of incremental pipeline capacity in the New England area. Although excess capacity may be sold in daily

[2] The Company's tariff filing also includes certain minor administrative changes to the tariff. We reviewed those administrative changes in the Company's tariff and find them acceptable.

[3] Capacity resources have been planned by National Grid, as well as many other natural gas distribution utilities, to meet gas supply demands under extreme (design day) weather conditions **plus** a reserve. This means that even under design day conditions, the Company is likely to have some excess gas delivery capability that can be sold to competitive gas service providers.

markets at a significant premium when weather approaches design day conditions and gas system demands rise, such weather extremes have been rare. During winters when extreme cold weather was not experienced and design day conditions represented demands well in excess of actual peak day demands, excess gas supply capacity could be purchased from local gas distributions utilities ("LDC") at substantial discounts from FERC-approved rates. As a result, marketers have generally found reliance on daily purchases of spot gas in the local market to provide gas supply on peak days more economic than commitments to the annual costs of pipeline, storage, and/or local peaking supply capacity.

However, declining natural gas commodity prices have led to increased use of natural gas in the region, particularly by electric generators who tend to provide the marginal sources of electricity supply during period of cold weather. With such increases in natural gas demand, the local market for excess utility gas supply resources has tightened. As a result, daily prices for spot purchases of natural gas in local markets during periods of extreme cold weather have soared to record levels.

THE CURRENT SITUATION

National Grid has indicated to the Division that it has **111 current Capacity Exempt customers**. The Company also assesses that if all of those current Capacity Exempt customers elect to relinquish their Capacity Exempt status and seek firm service from National Grid, approximately **38,000 Dth per day** of design day capacity requirements would be added to the system. National Grid also indicates that at present it only has about **2,000 Dth per day** of design day delivery capacity available that could be used to serve current Capacity Exempt customers who may elect to change their status and receive an allocation of capacity from the Company. Thus, National Grid does not have the ability at this time to provide firm peak day supply service to all, or even a large percentage, of the load represented by current Capacity Exempt customers in Rhode Island.

The Company's proposed participation in the Tennessee Gas Pipeline ("TGP") Northeast Energy Direct ("NED") project would provide National Grid 35,000 Dth per day of capacity with a projected in-service date of November 1, 2018. However, 15,000 Dth per day of that capacity would represent a replacement of existing contracted interstate pipeline capacity for which the Company's current contractual commitment is scheduled to expire. Thus, **if there is no growth** in the peak day demands for the Company's **firm** (non-capacity exempt) customers in Rhode Island, the 35,000 Dth per day of NED capacity that National Grid is considering would only be adequate to address a little over half of the potential requirements of current Capacity Exempt customers. Assuming 1% per year growth in Rhode Island total firm design day requirements for current Capacity Assigned customers, National Grid will add approximately 10,000 Dth per day of addition service requirements for Firm Sales Service and Capacity Assigned Firm Transportation Service customers. Thus, National Grid's design day capacity requirements for firm service customers, without consideration of current capacity exempt customers' requirements, would require roughly half of the incremental 20,000 Dth per day of TGP NED project capacity by the expected in service date for that project. By November 2021, just three years later, essentially all of the incremental TGP NED project capacity could be required to meet the requirements of the Company's firm service customers without any provision of current Capacity Exempt customers. Importantly, there is **no scenario** that can be identified at this point under which National Grid would have adequate capacity to meet ALL of the potential requirements of current Capacity Exempt customers.

Moreover, the capacity costs associated with the NED capacity are substantially in excess of National Grid's current average cost of city gate capacity. The capacity the Company would obtain from the NED project would represent no less than 25% of the Company's total current city gate pipeline capacity, but costs of that capacity could exceed 50% of the Company's current total annual pipeline capacity costs for Rhode Island. Thus, adding capacity to serve the potential needs of Capacity Exempt customers could add significantly to National Grid's average costs of capacity for its Rhode Island firm service customers.

THE PROPOSED PROGRAM CHANGES

The changes the Company proposes in its Gas Customer Choice Program have three basic elements. Those elements include:

- Clarification of tariff provisions regarding the conditions under which Capacity Exempt customers may return to National Grid firm service offerings and the pricing of firm service for such customers;

- Inclusion in the Company's tariff of a one-time opportunity for existing Capacity Exempt customers to return to firm gas service with capacity provided by National Grid that may be exercised at any point in time subject to certain conditions; and

- Implementation of pricing provisions that are intended to achieve a more equitable distribution of cost responsibilities between existing Capacity Exempt customers who elect to receive an assignment of capacity from National Grid and Firm service customers who presently bear the costs of National Grid's capacity resources. This includes consideration of both (1) the costs of pipeline, storage, and local peaking supply capacity maintained by the Company and (2) incremental gas supply costs incurred in the near-term to serve previously Capacity Exempt customers.

RESPONSE OF SANTA BUCKLEY ENERGY

On October 2, 2015, Santa Buckley Energy, Inc. ("SBE") filed comments regarding National Grid's proposed modifications to its Customer Choice Program. SBE supported the Company's proposal to provide Capacity Exempt customers the option to become capacity assigned, but SBE does not support a requirement that such customers must return to utility sales service for a period of time to become eligible to receive an assignment of capacity from National Grid.

SBE argues that the Company's proposals place the marketer's relationship with the customer "*at risk*," and there is no reason that marketers should have to "*cede the customer to the Company in the interim period*." SBE also addresses what it characterizes as National Grid's fear that customers will return to the Company "*in the middle of the winter without adequate notice*." SBE argues that this fear is not justified give the Company's ability to control when a customer's transition to capacity assigned status takes place.

RESPONSE OF DIRECT ENERGY

Direct Energy ("DE") filed testimony by witnesses Hanks and Magnani on October 5, 2015 which also responds to National Grid's Customer Choice Program proposals. As set forth in that testimony, DE's concerns are: (1) that the Company's proposed Customer Choice Program tariff proposals are flawed; and (2) that those proposals will harm natural gas competition in Rhode Island. Witness Hanks for DE also expresses considerable concern regarding the process through which National Grid's proposals were developed.

EVALUATION OF PROPOSED CUSTOMER CHOICE PROGRAM CHANGES

The experience of the last couple of winters has demonstrated the effects of limited existing natural gas pipeline capacity into New England on natural gas prices and capacity availability during periods of extreme cold weather. That experience has also served to highlight: (1) the desire of a number of present Capacity Exempt customers to return to Capacity Assigned status; and (2) the impacts that customers returning unexpectedly to National Grid provided gas service can have on the Company's cost of gas for other firm service customers in Rhode Island. In that context, the need for changes to National Grid's Customer Choice Program is apparent.

Given changes in market conditions, it is reasonable to provide existing capacity exempt customers the opportunity to relinquish their capacity exempt status and return to reliance on the Company for the provision of firm natural gas supply capacity, as long as: (a) the terms and conditions established for transfers to Capacity Assigned service are appropriate and not unduly discriminatory; and (b) the pricing of service to customers who relinquish their current Capacity Exempt status does not adversely impact existing firm Capacity Assigned customers for whom the system's capacity resources have been planned. National Grid clearly represents that its current planning of capacity resources does not include consideration of the requirements of Capacity Exempt customers. It is also reasonable that the election of an existing Capacity Exempt Customer to relinquish their capacity exempt status be a **permanent** decision. (The only exception we might envision is if the Customer gives the Company at least five years advance notice of their re-election of Capacity Exempt status.)

The rationale National Grid offers for its proposed changes focuses primarily on reliability considerations (and the specifics of those reliability considerations are not well developed or quantitatively supported). However, service reliability, although important, should not be the sole consideration guiding the Company's policies with respect to providing current Capacity Exempt customers an option to return to Capacity Assigned service. The cost impacts of such a policy and the equitable assignment of responsibilities for incremental costs associated with the exercise of such an option must also be considered. Moreover, the reliability of service to existing firm capacity assigned customers should be adequately protected, as SBE and DE argue, through National Grid proposal to retain the right to deny transfers to Capacity Assigned status if it is not have sufficient capacity to serve a customer who requests such a transfer. Thus, from the Division's perspective, the key outstanding issues associated with the proposed modifications to National Grid's Customer Choice Program are primarily economic issues relating to: (1) equitable treatment of existing firm sales and capacity assigned transportation service customers; and (2) proper attribution of incremental costs to the customers responsible for National Grid's incurrence of such costs.

As previously noted, the Company's existing capacity resources have been developed to serve firm sales service customers and capacity assigned firm transportation service customers. The gas supply capacity requirements of Capacity Exempt customers have not been included in the planning of those resources. Therefore, requests for Capacity Assignment by current Capacity Exempt customers represent unplanned additions to the Company's capacity requirements and costs, and rational pricing of such incremental capacity requirements must be developed. While National Grid proposes to provide Capacity Exempt customers the opportunity to receive capacity assignments at the Company's average capacity cost, that pricing proposal does not yield reasonable and equitable treatment of the vast majority of Rhode Island's firm gas service customers who have either not had the option, or not elected to exercise the option, to be exempted from capacity cost responsibilities.

Rather, equitable treatment for existing firm capacity assigned gas service customers dictates that current Capacity Exempt customers who return to Capacity Assigned status should be assessed the incremental costs associated with meeting their design day capacity requirements. To do otherwise would provide an improper price signal and would encourage uneconomic additions of load to the Company's system.

National Grid's proposals recognize that the unanticipated return of a Capacity Exempt customer to National Grid-supplied sales service can also result in the Company's incurrence of incremental gas supply commodity costs, particularly during periods of extreme cold weather that can adversely impact National Grid's overall average commodity costs for GCR customers. National Grid has addressed this concern through its proposed "Interim Market Rate." Keeping in mind that National Grid starts purchasing/hedging gas supplies for each gas supply month **24 months** in advance, estimated gas volumes for such a customer will not have been included in the volumes for which gas purchases/hedging contracts have been executed prior to the customer's notification of National Grid of its decision to return to Firm Gas Sales Service. Thus, the Company's proposed interim pricing of gas sales to a customer who seeks to return to Firm Gas Sales Service with little advance notice is reasonable. Although an argument can be made that such a customer should be billed the interim rate for up to 24 months,[4] the Commission should support the Company's pricing proposal during a transition period for gas **commodity purchases** by a current Capacity Exempt customer that requests Firm Gas Sales Service. However, an argument can be made that this rationale would also be applicable to any current Gas Transportation Service customer who returns to Firm Sales Service without substantial advance notice.

If large and extra-large Capacity Exempt customers are permitted to return to National Grid for the provision of pipeline and/or storage and peaking capacity, the Company can be expected to incur costs for incremental capacity that are significantly above its current average capacity costs per dekatherm of capacity requirement. Yet, it is clear from the Company's forecasts that residential and small commercial customer service requirements are not expected to contribute to the Company's need for additional capacity. The Company's forecasted growth lies primarily in its medium, large and extra-large C&I service classifications. This raises questions regarding the appropriateness of asking smaller customers to bear significant increases in the gas supply capacity costs when they do not contribute, or do not contribute proportionally, to the Company's need for incremental capacity resources. In that context, the adequacy of capacity upstream of National Grid's city gates and maintenance of the operational integrity of the Company's distribution system, while important, should not be the only considerations that dictate whether capacity is offered to current Capacity Exempt customers or under what terms capacity is offered to those customers. Importantly, the Company's proposal to provide capacity to current Capacity Exempt customers who elect to relinquish their Capacity Exempt status at its **average cost of capacity** fails to yield a reasonable and equitable assignment of cost responsibilities. Instead, Capacity Exempt customers who seek assignments of capacity from National Grid should be assessed the Company's incremental cost of capacity (e.g., the cost of Tennessee Gas Pipeline NED Project capacity) until the Company has sufficient time to re-optimize its portfolio of capacity resources (i.e., a period that reflects the time to acquire and place into service new long-

[4] Twenty-four (24) months represents the period over which National Grid hedges gas pricing for gas supplies in advance of each gas supply month. The "up to" language is intended to allow for recognition of the concept that a customer who provides less than 24 months of advance notice should only be held responsible for paying interim market rate for gas supply commodity charges for a period that reflect the difference between the length of National Grid's hedging period and the amount of advance not the customer actually provides. For example, if a customer provides six (6) months of advance notice of its intent to return to gas sales service, then the customer might arguably be held responsible for paying Interim Market Rate for eighteen months. Noting that the Interim Market Rate and the applicable GCR rate are likely to be the same throughout most non-peak months and even some winter months if weather is mild, this example may not produce results that differ substantially from the Company's proposal.

term capacity commitments). Based on recent experience, that would appear to be a period of at least three-years after their execution of a commitment to capacity assigned service.

At page 9, lines 7-12, of the Company's filed testimony in this proceeding, the witnesses for National Grid respond to a question regarding the reasons for the Company's current assignment of capacity to customers under the customer choice program. That response fails to address two important elements of the capacity assignment rationale.

First, prior to the introduction of transportation service alternatives[5] the Company had developed a portfolio of gas supply capacity resources sufficient to serve the requirements of all of its Firm Service customers. Many of those resources represented long-term fixed cost commitments. When some customers opted to use transportation service without receiving an assignment of capacity (i.e., elected Capacity Exempt status), the system was effectively left with substantial "stranded costs" for capacity that was no longer required to serve requirements of customers who could not, or did not make such an election. For those customers who transferred to Transportation Service but retained Capacity Assigned status, the Company avoided exposure to possible stranded costs.

Second, the Company's portfolio of long-term capacity commitments has been developed over time and generally provides National Grid an average cost for capacity that is below the cost at which gas marketers can obtain similar firm capacity commitments (*assuming that there is capacity available to serve the New England market – an assumption that clearly has not prevailed in recent years*). If gas marketers only option was to purchase firm annual gas supply capacity at prices above the utility's average capacity costs, their costs of capacity would significantly erode the price competitiveness of the gas supply alternative they could offer. In other words, any cost savings they could obtain for customers in the purchasing of commodity gas would be offset by increases in firm capacity costs. Moreover, as margins on natural gas commodity sales in competitive markets tend to be fairly small, a cost for capacity above the utility's average costs could render their service offerings uncompetitive. In this context, assignment of gas supply

[5] Transportation service options were initially authorized only for Medium, Large, and Extra Large C&I customers. Although transportation service options have subsequently been extended to Small C&I customers, residential customers do not have such options and those customers who do not have transportation service alternatives must be protected from externalities (i.e., increased costs) that might be imposed by the offering of transportation service alternative to non-residential customers.

capacity to marketers at the Company's average cost of capacity facilitates marketers' ability to compete for gas supply service.[6]

Massachusetts has adopted an approach for providing an option for Capacity Exempt customers to obtain assignments of utility capacity resources that we do not support for Rhode Island. Massachusetts has directed its gas distribution utilities to plan sufficient capacity to provide for the return of ALL current Capacity Exempt customers to capacity assigned service without mandating that such customer must purchase capacity from their utility. In the case of Rhode Island, such a policy would require National Grid to add about 38,000 Dth per day to its design day sendout without any assurance that all eligible customers would elect that option. As a result, customers that are provided capacity by the utility could be required to bear the burden of substantial added costs for unassigned capacity (i.e., stranded costs). In other words, any capacity obtained by the Company to serve a current Capacity Exempt customer that elects NOT to return to capacity assigned status would result in excess capacity for National Grid, and the costs for such excess capacity would most likely fall on the Company's existing capacity assigned customers who would derive no incremental benefit from the maintenance of capacity in excess of their design day requirements.

Further, the Commission should recognize that a Capacity Exempt customer who seeks to revert to Capacity Assigned status is not the same as a new customer that starts taking service from National Grid for the first time. The requirements of Capacity Exempt customers are known, and the capacity requirements of those customers have been specifically excluded from the Company's planning. Although allowances for customer growth are effectively built into the Company's forecasts, none of that growth is intended to reflect growth in Capacity Exempt customers' annual throughput and design day requirements. However, any use of capacity amounts included in the Company's forecasts and planning for **new customers** to serve current Capacity Exempt customers may limit or foreclose National Grid's ability to economically serve potential new customers. That, in turn, could stymie opportunities for economic development within Rhode Island.

Finally, the Commission should recognize that an inherent inconsistency exists between National Grid's capacity planning which excludes the requirements of Capacity Exempt

[6] Margins on natural gas commodity sales are generally limited by competitive forces, thus purchases of pipeline capacity (or other capacity resources) at a cost above the utility's average cost of capacity would service to further erode the net margins that marketers can expected on commodity sales and could conceivably eliminate that ability to compete effectively for the provision of retail gas supply services.

customers and the Company's perception that it must be prepared to provide firm service to any and all current Capacity Exempt customers who request Default Service. It is not reasonable or appropriate for National Grid to have an obligation to provide Firm Service to a current Capacity Exempt customer under its Default Service rates (particularly under extreme winter weather conditions) when the Company has not planned capacity to service such customers. The Company's efforts to assume such an obligation only services to increase costs and jeopardize service reliability for its current capacity assigned sales and transportation service customers. The Company's tariff could be amended to require each marketer that serves Capacity Exempt customers to annually demonstrate prior to the start of each winter season that the marketer has contracted for sufficient firm capacity to serve the Capacity Exempt customers' design day requirements. Alternatively, if operationally the Company cannot ensure marketers' ability to serve Capacity Exempt customer loads, then the Company's tariff may need to be amended to require that adequate metering and controls be installed for Capacity Exempt customers to avoid their unauthorized use of system capacity under extreme weather conditions.

ASSESSMENT OF MARKETER INPUT

We agree with SBE and DE that National Grid's proposal to require a customer to return to the Company's Firm Sales Service for a period of time may be unnecessary. However, removal of the Company's requirement for current Capacity Exempt customers to return to National Grid's Sales Service must be replaced with provisions for incremental pricing of capacity provided to such customers for a period of at least three years. We also agree with the testimony of DE witness Magnani that National Grid already has most, if not all, of the information it would require to plan capacity to meet the requirements of current Capacity Exempt customers. On the other hand, we do not necessarily accept other elements of the arguments and rationales that SBE and DE present in it filed comments and testimony.

The terms of capacity exemption as set forth in the Company's tariff have been clear since the initial offering of gas transportation services in Rhode Island in the early 1990s. National Grid's portfolio of pipeline capacity commitments is not "*low hanging fruit*" to be picked by Capacity Exempt customers at their convenience. Customers who have explicitly elected to be Capacity Exempt have not been included in the Company's capacity planning and have not been required to support the costs of the Company's capacity commitments. In that context, those customers have no inherent claim to any portion of the capacity National Grid currently maintains to serve firm service customers who have NOT elected Capacity Exempt status.

The presumption of Capacity Exempt status, when that option was created, was that customers who elected not to receive an assignment of capacity and responsibility for the associated capacity costs would be able to contract through marketers for capacity to meet their firm service requirements. Now, more than two decades later, we find that at least some Capacity Exempt customers and their competitive suppliers did not take appropriate measures to ensure the reliability of their service under extreme weather conditions. Although it may be reasonable under appropriate conditions to allow current Capacity Exempt customers an opportunity to reconsider their prior decisions and seek to revert to capacity assigned status, any such offering should not impose added costs on customers for whom National Grid has planned those resources.

If there is to be a "*consensus*" reached regarding appropriate Customer Choice Program policies for National Grid, any such consensus must reflect input from all affected stakeholders, including both the Company's current Capacity Exempt customers and the vast majority of the Company's customer base that is represents Firm Sales Service customers and Capacity Assigned Transportation Service customers. Decisions reached in a room populated primarily by marketers and National Grid representatives cannot be relied upon to reflect a consensus of all affected stakeholders.

SBE's claim that the Company's proposals place marketer's relationship with customers at risk mischaracterizes the situation. It is not the Company's proposals that have place marketers relationship with customers at risk. Rather, it is the marketers' failure to secure commitments of firm capacity to serve their Capacity Exempt customers' requirement that now places their service to those customers at risk. Moreover, SBE improperly suggests that the Company's proposed modifications of its Customer Choice Program would require marketers to "*cede*" customers to the Company. However, decisions regarding whether a customer will return to Capacity Assigned service would be decisions made by the customer, not by marketers and not by National Grid. There would be no interest or desire on the part of Capacity Exempt customers to return to capacity assigned service, if customers perceived that marketers could satisfy their service requirements at lower cost. When a current capacity exempt customer exercises its option to return to capacity assigned status under the proposals that National Grid presents in this proceeding, it will reflect the customer's assessment that National Grid's offering provides value that exceeds the value of the gas supply service offerings available to the customer through the competitive market. Nothing in the Company's proposals prevents marketers from offering equal or higher value services at lower prices. However, the regulatory process can and should limit the pricing National Grid offers for such service to protect the interests of its other customers. Thus, National Grid should only be permitted to offer capacity to current Capacity Exempt customers at a level that ensures the Company's existing firm service capacity assigned customers are not adversely impacted the return of Capacity Exempt customers to Capacity Assigned service. Thus, National Grid faces regulatory constraints on its ability to offer competitive pricing of service to current Capacity Exempt customers that are not faced by marketers.

SBE's presentation also places undue focus on the potential that a customer might return to National Grid's capacity assigned service during the middle of the winter season. Although the return of a customer to capacity assigned status during the middle of the winter without substantial advance notice could have particularly adverse impacts on National Grid's existing firm capacity assigned customers, the focus should not be placed solely on returns during the middle of the winter. As previously discussed herein, the return of a current Capacity Exempt customer without substantial advance notice at any time during a year can adversely impact National Grid's costs and reliability of service for other firm capacity assigned customers. As we see in the case of National Grid's plan to add capacity from the TGP NED project, there can be a lead time of more than three years to negotiate contracts for new capacity, construct the capacity, and place it in service. Moreover, the costs of such incremental capacity can be well in excess of the Company's current average pipeline capacity costs.

Witness Magnani for Direct Energy makes numerous representations regarding National Grid's current Capacity Exempt customers and what they want. However, nothing is offered to demonstrate that DE's witness actually speaks for any substantial element of National Grid's customers in Rhode Island. The fact that at least some current Capacity Exempt customers have sought to return to Capacity Assigned service underscores the existence of shortcomings in the services that marketers have offered to those customers.

Direct Energy, through the testimony of witness Magnani recognizes that Capacity Exempt customers' requirements are NOT presently included in National Grid's system planning. He also suggests that a customer could sign "*a non-rescindable letter of authorization stating that it wishes to become capacity assignment eligible* …" and that "*will provide sufficient notification to allow NGrid to include the customer in its system planning*." The concept of advance notice of a desire to become capacity assignment eligible is reasonable. Moreover, if a customer provides sufficient advance notice for the Company to plan and bring into service new capacity to serve the customer's requirement (e.g., at least three to four years advance notice based on TPG NED project lead times), it would be reasonable for such a customer to receive capacity from National Grid at its average capacity cost, thereby avoiding the need to pay charges based on the Company's incremental costs of capacity. However, if the customer seeks an assignment of capacity with lesser advance notice: (a) the customer's access to such capacity should be limited to by the amount of demonstrated capacity in excess of the Company's design day capacity requirements; and (b) the customer should be subject to incremental costs for any capacity assigned for the number of months that its advance notice falls short of the established minimum advance notice requirement for avoiding incremental pricing.[7]

At page 14 of DE's testimony, Witness Magnani suggests that a customer who seeks Capacity Assigned status from National Grid would never be able to return to Firm Transportation Service. This is incorrect. National Grid's proposal only requires a customer to take Firm Sales Service for a limited transition period. After the transition period is completed, the Company's proposals allow for the customer to return to Firm Transportation service with an assignment of capacity. Although the Company's proposed requirement that a customer to take Firm Sales Service for a limited period of time may be unnecessary if capacity assignments for customers who relinquish their Capacity Exempt status are priced to reflect the Company's incremental capacity costs, the Company's proposals would not deny a customer the opportunity to transfer to Capacity Assigned Firm Transportation service after they have met the requirements to receive an assignment of capacity from National Grid.

EVALUATION OF PROPOSED TARIFF CHANGES

Section 1, Schedule B, Definitions, Sheets 1 and 2:

Definitions of "Capacity Assigned Customer," "Capacity Assignment," "Capacity Exempt Customer," and "Capacity Exemption."

The proposed definition of "**Capacity Assigned Customer**" addresses the customer's "premises." *Should this reference the customer's designated "service" to allow for the*

[7] If, for example, a customer provides six months of advance notice before receiving an assignment of capacity from National Grid, the customer should be required to pay 30 months of charges based on incremental pricing, after which the customer could then have capacity priced at National Grid's average cost of capacity.

fact that a non-residential customer may have more than one account for which service is provided at the customer's premises?

The proposed definition of "**Capacity Assignment**" only addresses the assignment of "***pipeline capacity***" for FT-1 customers. *Are there any circumstances under which an capacity assigned FT-1 service customer could be provided, and should be held responsible for, costs for storage and peaking capacity (e.g., if an FT-1 customers seeks service under National Grid's Default Service tariff provisions)?*

The definition of "**Capacity Exempt Customer**" as presently stated in the tariff implies that a "Capacity Exemption" is granted to a physical location rather than to a service account. *Does this adequately address situations (such as Kent County Hospital) in which the customer may receive service for more than one account at a single location where some of the service at the location is not considered "Capacity Exempt"?*

The definition of "**Capacity Exemption**" as presented in the current tariff has two potential problems. First, this definition, once again, focuses on a "location" having gas usage that is not subject to a mandatory pipeline capacity assignment from the Company. This focus on the customer's service location may need to be revised to address the potential that a customer may have both "Capacity Exempt" and "Capacity Assigned" service at the same location.

Section 1, Schedule B, Definitions, Sheet 4:

The definition of "**GCR Rate**" is incorrect as presented and needs to be refined. The "**GCR Rate**" should be defined as the applicable gas supply rate under the provisions of Section 2 of the Company's tariff. The Company should also clarify that the GCR rate only addresses recovery of gas supply commodity and capacity charges and that the customer will continue to be responsible for applicable base rate charges for gas distribution service.

Section 1, Schedule B, Definitions, Sheet 8:

The "**Winter Season**" is defined as the period from November 1 through April 30. For the purpose of developing GCR charges National Grid uses a winter season which runs November 1 through March 31.[8] *Why are these periods different*? National Grid needs

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[8] See for example Attachment AEL-1, Page 12 of 15, in Docket No. 4576,

to provide further support and justification for the difference between these winter season definitions. If the April 30 date reflects a lag in the billing of winter season gas use, then a similar lag should be applied in the fall of each year resulting in a winter season commences on December 1 rather than November 1 for the purposes of the proposed Customer Choice Program tariff changes.

Section 6, Transportation Terms and Conditions, Schedule C, Sheet 3:

The language presented states, "*FT-1 Transportation Service Customers who are Capacity Exempt Customers must confirm their intention to retain their Capacity Exempt Status or relinquish their Capacity Exemption and affirmatively elect to receive assignment of the Company's capacity resources when seeking to receive their gas supply from the Company*." This language triggers two concerns. First, the provision is unclear regarding **when** such customers must "*confirm their intent to retain their Capacity Exempt status*." Second, the rationale and justification for limiting the assignment of capacity to such customers to situations where the customer requests gas supply from the Company is not well-developed. Why is it necessary or appropriate to tie this to when the customer is "*seeking gas supply from the Company*"?

As discussed herein, a more appropriate solution may be to allow Capacity Exempt Customers to request capacity assignments from National Grid without taking gas from the Company. However, such assignments of capacity should only be permitted if the capacity provided to current capacity exempt customers is priced in a manner that is reflective of National Grid's incremental cost of firm pipeline capacity for a transitional period of at least three years. Incremental pricing of capacity assigned to current Capacity Exempt customers would service four functions:

1. Ensure that added costs are not imposed on existing Firm Gas Sales customer and Capacity Assigned Firm Transportation customers as a result of Capacity Exempt customers' decisions to return to Capacity Assigned status;

2. Provide an appropriate economic price signal to current Capacity Exempt customers who may consider returning to Capacity Assigned service;

3. Discourage wholesale shifts of current Capacity Exempt load to Capacity Assigned service when the Company's system in Rhode Island does not

have identified resources to serve the entirety, or even a large percentage of existing Capacity assigned customer requirements;

4. Provide a greater opportunity for competitive service providers to develop and offer service alternatives that might meet Capacity Exempt customers' requirements more economically from non-utility resources.

Section 6, Transportation Terms and Conditions, Schedule C, Sheets 20 and 21:

<u>Paragraph 2.05.0, Relinquishment of Capacity Exempt Status</u>: This provision links the assignment of capacity to being eligible to receive gas from the Company at a rate other than the Default rate. This linkage between capacity assignment and receipt of gas from the Company may be unnecessary. Certainly, if an existing Capacity Exempt customer wishes to receive Firm Sales Service, relinquishment of the customer's Capacity Exempt status should be a prerequisite. However, if an existing Capacity Exempt customer only wants an assignment of capacity and intends to remain a Firm Transportation Service (FT-1 or FT-2) customer, denial of capacity to such a customer appears inappropriate as long as:

1. The customer requesting a capacity assignment (for either sales of transportation service) bears the Company's incremental cost of capacity over a reasonable planning horizon (i.e., the amount of time required for the Company to contract for and start receiving service from a new gas supply resource such as the TGP NED project -- roughly a three to four year period);[9] and

2. The customer makes an on-going commitment to the use of the Company's capacity such that National Grid can include the customer's capacity requirements in its future long-term capacity planning.

[9] Applying a concept similar to that which the Company sets forth in "Interim Market Rate" proposal for gas **commodity** purchased by a customer who relinquishes its Capacity Exempt status, the Company should also apply an "***Interim Gas Capacity Charge***" to such customers. However, the "***Interim Gas Capacity Charge***" would have a long period of applicability.